No. 83-863

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1983

MID-AMERICA TELEVISION COMPANY
and
OLIVER ADVERTISING, INC.,
Petitioners,
v.
STATE TAX COMMISSION OF MISSOURI
and
DENNIS K. HOFFERT, Chairman,
and
ROBERT C. SNYDER, Commissioner,
Respondents;
WELLS ALUMINUM, INC.,
Petitioner,
v.
ADMINISTRATIVE HEARING COMMISSION
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF MISSOURI

BRIEF OF RESPONDENTS IN OPPOSITION TO WRIT OF CERTIORARI

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January, 1984

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QUESTIONS PRESENTED

I.

Whether the Missouri Income Tax Law as construed by respondents violates the Equal Protection provision of the Fourteenth Amendment to the Constitution of the United States in that it requires corporate taxpayers filing individual Missouri returns to deduct only a proportionate share of the federal income tax actually paid in the consolidated federal return filed by the affiliated group to which the individuals belong rather than allowing a deduction on the basis of the federal taxes which would have been paid had the individual member filed an individual federal income tax return?

II.

Whether the Missouri income tax law violates the Equal Protection provision of the Fourteenth Amendment to the Constitution of the United States in that it only permits the filing of a consolidated Missouri return where a consolidated federal return was filed and the affiliated group conducts more than half of its business activities within this state?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutions and Statutes

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SUPPLEMENTAL STATEMENT OF THE CASE

Petitioners herein attempt to create an Equal Protection violation of the Fourteenth Amendment to the United

States Constitution and thereby obtain a writ of certiorari to the Supreme Court of Missouri because of the construction of the Missouri income tax law as applied to the petitioners in determining the appropriate deduction for federal income tax liability. Petitioners have filed jointly for a writ of certiorari because of the identity of issues even though the controversies were separate below. Both petitioners are members of affiliated groups of corporations which filed consolidated federal income tax returns and paid a single federal income tax as a consolidated group. However, both petitioners filed separate Missouri corporate income tax returns.

In 1972, the General Assembly of Missouri passed a comprehensive income tax law for the state, effective January 1, 1973. 1972 Laws of Missouri, S.B. 549. In part, the law was based upon the enactment of Art. X, § 4(b), Missouri Constitution, which allowed the General Assembly to define income by reference to the laws of the United States. In keeping with this article, § 143.431.1, RSMo 1978,[1] provides that the starting point for determining Missouri taxable income is federal taxable income. When an affiliated group of corporations files a consolidated federal income tax return and a consolidated Missouri return, the federal consolidated taxable income becomes the Missouri taxable income for that group. In § 143.431.3(1), RSMo 1978, an affiliated group of corporations filing a consolidated income tax return for federal income tax purposes is permitted to file a Missouri consolidated income tax return if fifty percent or more of the group's income is derived from sources within this state.

However, for those corporations who are not permitted to file a consolidated return under the Missouri statute, or

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[1]All references to the income tax law of Missouri are to the 1978 edition unless otherwise noted.

who elect not to, the Missouri legislature created a means of determining Missouri taxable income without reference to the federal return since the federal return dealt with the consolidated group and not the individual members thereof. Accordingly, in § 143.431.3(4), RSMo 1978, individual members of an affiliated group filing a federal consolidated return but not filing a Missouri consolidated return are required to determine federal taxable income as if a separate federal income tax return had been filed and to use this hypothetical figure as the starting point on its Missouri return, i.e., Missouri taxable income.

Although petitioners now claim that the Missouri law restricting the filing of a consolidated Missouri income tax return to those affiliated groups of corporations who file a federal consolidated income tax return and derive fifty percent or more of the group's income from sources within this state is constitutionally suspect, petitioners' original allegations dealt only with the appropriate deduction to be allowed on the Missouri income tax return for federal income tax liability. In Missouri, deductions from tax are matters of legislative grace and the taxpayer claiming a privilege must demonstrate that he comes within the terms of the statute. *Mobil Oil Corporation* v. *State Tax Commission of Missouri*, 513 S.W.2d 319, 322-23 (Mo. 1974). Section 143.171.1, RSMo 1978, allows a taxpayer in Missouri to deduct his federal income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed, with certain modifications not material to this controversy. This section has been made specifically applicable to corporations by § 143.431.2, RSMo 1978, with the added restriction that where a corporation derives only part of its income from sources within Missouri, the deduction available under § 143.171 is allowed only the extent applicable to Missouri. Section 143.451.8, RSMo 1978.

Although nothing in Missouri law specifically authorizes the practice, petitioners claim the right to hypothetically calculate the federal income tax payable had they filed an individual federal income tax return and use that hypothetical figure as their federal income tax liability for purposes of deduction. For the tax year in controversy, Oliver Advertising, Inc., would have paid $50,491 in federal tax had it filed as an individual corporation. Mid America Television Company would have paid $63,531 to the Federal government in payment of its federal income tax had it filed on a separate basis rather than as a member of a consolidated group. Yet, the record demonstrates that the federal tax actually paid by the consolidated group to which these two petitioners belonged for the year in question was $14,933.

Since the only amount paid as a federal income tax liability to the United States Government was the amount paid by the affiliated group to which these two petitioners belonged, the Missouri Director of Revenue denied the right to deduct as federal income tax on the Missouri returns an amount which would have been paid as federal income tax if the petitioners had filed a separate federal return. The Director did not attempt to deny any deduction for federal income tax paid, but attempted to allocate the tax actually paid to the federal government by the affiliated group. He chose a method utilized by the Internal Revenue Service for allocating federal income tax paid by a consolidated group to each individual member for the purpose of determining earnings and profits. *See,* 26 U.S.C., § 1552. Specifically, the Director determined each petitioner's share of the consolidated group's federal tax by multiplying the actual federal tax paid times a fraction consisting of the taxable income of each petitioner in the numerator and the taxable income of the entire group in the denominator. This formula allowed a deduction for a portion of the

federal taxes paid by the affiliated group based on the relationship of each individual's taxable income to the taxable income of the entire group.

A similar situation occurred with respect to the other petitioner herein, Wells Aluminum, Inc. That is, the deduction for federal income tax liability allowed by the Missouri Director of Revenue based upon the petitioner's proportionate share of the consolidated group's actual tax liability, as demonstrated above, was less than the deduction claimed by the petitioner based upon the federal taxes it would have paid had it filed a separate federal return.

REASONS WHY THE WRIT SHOULD BE DENIED

I.

The Missouri income tax law as construed by respondents does not discriminate against petitioners or create an unconstitutional classification, but rather simply limits the deduction available for state income tax to all corporations who file consolidated federal income tax as a member of a group but file Missouri income tax as an individual corporation by requiring that the deduction available under state law be limited to a proportionate share of the federal taxes actually paid by the group and not a hypothetical tax based upon an individual federal income tax return which was never filed.

Petitioners' attempt to create an invidious discrimination in violation of the Equal Protection clause of the Fourteenth Amendment to the Constitution of the United States so as to justify the issuance of a writ of certiorari borders on the incredulous. It might be humorous if it were not for the situation petitioners have created in the State of Missouri. Many assessments were held in abeyance in this state pending the final determination of the issue by the Missouri Supreme Court. Subsequent to the decisions in *Mid-America Television Company and Oliver Advertising, Inc.* v. *State Tax Commission of Missouri*, 652 S.W.2d 674 (Mo. banc 1983), and *Wells Aluminum, Inc.* v. *Administrative Hearing Commission*, 652 S.W.2d 687 (Mo. banc 1983), as well as several other cases involving the same issue which were decided by the Missouri Supreme Court at the same time, payment of the outstanding assessments was begun by other litigants and taxpayers whose disputes were held in abeyance pending resolution. Petitioners, for their own business purposes, have created confusion by refusing to pay the outstanding assessment and requesting

stays of the mandate issued by the Missouri Supreme Court to the lower courts in Missouri pending resolution of the writ for certiorari.

This has been done in spite of the fact that this Court has made it very clear on several occasions that equal protection is not favored as a means of challenging taxing statutes by the various states. In *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S.Ct. 101, 103, 35 L.Ed.2d 351 (1973), this Court said:

> Where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation.

In *Walters* v. *City of St. Louis*, 347 U.S. 231, 237, 74 S.Ct. 505, 98 L.Ed. 660, 665 (1954), this Court said:

> Equal protection does not require identity of treatment. It only requires that classification rest on real and not feigned differences, that the distinction have some relevance to the purpose for which the classification is made, and that the different treatments be not so disparate, relative to the difference in classification, as to be wholly arbitrary.

No one would question the constitutionality of a statute allowing a taxpayer to deduct federal taxes paid when computing state income tax, even though that figure may vary depending upon the amount of federal tax paid. Rather than face this fact, petitioners have chosen to create an equal protection argument by arguing that Missouri income tax law discriminates against corporations which derive a substantial portion of their income in interstate or foreign commerce. However, this is not a question of income, it is a controversy involving the appropriate deduc-

tion for federal taxes paid. What is unreasonable or arbitrary about requiring an individual member of a consolidated group filing an individual Missouri return to deduct only a proportionate share of the federal tax actually paid by the group rather than to calculate a hypothetical federal tax which never existed?

The reality lies in the figures reviewed by the Missouri Supreme Court. Simply put, petitioners, Oliver Advertising and Mid America Television, attempted to deduct as federal taxes amounts well in excess of the tax paid by the entire consolidated group to the federal government. One could more easily argue that such a situation violates the equal protection of all other taxpayers who are restricted to deductions for actual liability, and not some hypothetical amount.

Petitioners' illustrations on pp. 12 and 13 of the joint petition for a writ of certiorari are not persuasive. They deal with three separate factual situations under which, quite understandably, three different tax liabilities result. Particularly amusing is the comparison between Example A, a situation in which several corporations file separate federal and Missouri income tax returns, and Example C in which federal consolidated returns are filed along with Missouri individual returns. In comparing these two, petitioners are especially upset by the fact that the total Missouri tax is $6,875 more under Example C than Example A, a situation which they claim constitutes unequal protection of law. Conveniently, they ignore the fact that the federal tax liability under Example C is $175,000 less than under Example A, thereby lowering the amount of the deduction available in Missouri for federal income taxes paid. One would suspect that the hypothetical corporations involved, if confronted with this choice, would probably exercise their option and file under Example C.

Furthermore, petitioners' illustrations do not take into account the "carryover" provisions of the Internal Revenue Code. In addition to the federal tax savings accruing to a consolidated group because of the presence of loss members, the intra-company payments distributed to the loss members because of the tax savings accruing to the group constitute an instant gratification of the loss members' right to "carryback" or "carry forward" losses against future or past profits. *See*, 26 U.S.C., § 172 *et seq.* In this fashion, the loss member or members of an affiliated group can be rewarded without ever showing a profit. Under the scenario painted by the petitioners, the "carryover" benefits available to the loss member or members are maintained through intra-company payments while, at the same time, petitioners are rewarded by way of deduction against state tax for federal income taxes paid on profits which were never actually subjected to federal tax by virtue of the affiliation with loss members and the filing of a consolidated federal return. In effect, the State of Missouri is being asked to subsidize these businesses by treating these intra-company "carryover" payments to affiliated loss members as deductions for federal taxes paid.

II.

Missouri income tax law does not create an unconstitutional classification or discriminate in violation of the equal protection provision of the Fourteenth Amendment to the Constitution of the United States by not allowing affiliated groups to file a consolidated Missouri return if a consolidated federal return had been filed but the group earned more than fifty percent of its income outside the state.

Petitioners have also argued that a writ of certiorari should be issued because § 143.431.3(1), RSMo 1978, violates the Equal Protection clause of the Fourteenth Amendment to the United States Constitution by refusing to al-

low an affiliated group of corporations to file a consolidated Missouri income tax return when less than fifty percent of its income is derived from sources within this state. Petitioners state that this classification has no reasonable basis. In discussing this question it is necessary to explore the basic purpose for allowing corporations to file consolidated returns. In discussing the federal statutes, the United States Court of Claims made the following statement:

> The basic purpose behind allowing corporations to file consolidated returns is to permit affiliated corporations, which may be separately incorporated for various business reasons, to be treated as a single entity for income tax purposes as if they were, in fact, one corporation. *American Standard, Inc.* v. *United States*, 602 F.2d 256, 261 (Ct. Cls. 1979).

In other words, some recognition has been given to the fact that a group of separate entities under law should be taxed as one when the relationship is such that they can be said to be pursuing a single business purpose. Thus, an affiliated group of corporations could, under certain circumstances, be taxed somewhat equally with one large corporation performing the same business operations within the same taxing jurisdiction. The same basic premise can be stated for the allowance of consolidated returns in Missouri. Under certain circumstances, the State of Missouri is willing to treat an affiliated group pursuing a single business purpose similarly to a single business enterprise. When viewed in this light, the requirement of § 143.431.3(1), RSMo 1978, that an affiliated group same business operations within the same taxing jurisdiction. The same basic premise can be stated for the allowance of consolidated returns in Missouri. Under certain circumstances, the State of Missouri is willing to treat an affiliated group pursuing a single business purpose similarly to a single business

enterprise. When viewed in this light, the requirement of § 143.431.3(1), RSMo 1978, that an affiliated group filing a consolidated federal income tax return must derive fifty percent or more of its income from sources within this state in order to file a Missouri consolidated income tax return is reasonable. A group deriving less than half of its income from sources within this state can hardly be said to be conducting a unitary business within this state. It would be unreasonable to expect the State of Missouri to accord such a group the same tax treatment available to a single entity performing all or most of its business operations herein.

This is especially true since the State of Missouri, like any other state, is only allowed to tax corporations on income derived from sources within this state. Many efforts have been made to insure that only such income is taxed, including the development of several formulas. *See,* § 143.451, RSMo 1978, which creates a statutory single-factor formula based on sales, and § 32.200, Subsection IV, RSMo 1978, the Multistate Tax Commission formula based on sales, property and payroll. This state has little reason to treat an affiliated group as a single taxpaying entity when less than fifty percent of the group's income is derived from sources within this state since the income earned by the members of the affiliated group outside the state is beyond the state's power to tax in any event. Where less than fifty percent of a group's income is derived from sources within this state, the State of Missouri is not receiving the benefit of a unitary business and cannot be precluded under the Equal Protection clause of the Fourteenth Amendment from imposing the requirements of § 143.431.3(1), RSMo 1978.

The tax imposed in Missouri on consolidated corporate groups falls equally upon all members within the clas-

sification set forth in this statute; the tax imposed falls equally upon all taxpayers who do not meet the qualifications set forth in the statute.

CONCLUSION

For these reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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January, 1984